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**COMMENTS OF VIRGIN ISLANDS TELEPHONE CORPORATION**

The Virgin Islands Telephone Corporation ("Vitelco") hereby submits these comments in response to the Common Carrier Bureau's *Public Notice*[1] seeking comment on the *Second Recommended Decision* recently released by the Federal-State Joint Board on Universal Service.[2] Vitelco supports the general proposal recommended by the Joint Board to hold states and carriers harmless. It also applauds the Joint Board's move away from the "25/75 split," especially given the fact that no intrastate toll service exists in the territory to generate the additional funds needed to cover a shortfall of funds under this split. However, Vitelco is concerned that specific aspects of the new methodology the Joint-Board recommends to implement the "hold harmless" proposal would actually fail to be successful in ensuring that carriers serving rural and insular areas

[1] *Public Notice*, "Common Carrier Bureau Seeks Comment on Universal Service Joint Board's *Second Recommended Decision*," DA 98-2410 (rel. Nov. 25, 1998) ("*Public Notice*").

[2] Federal-State Joint Board on Universal Service, CC Docket No. 96-45, *Second Recommended Decision*, FCC 98J-7 (rel. Nov. 25, 1998) ("*Second Recommended Decision*").

receive sufficient universal service support to maintain affordable telephone service as required by Section 254 of the Communications Act.[3]

## I. INTRODUCTION

On May 8, 1997, the Federal Communications Commission ("FCC" or "Commission") issued its *Universal Service Order* which, among other things, held that the federal universal service fund would provide only twenty-five percent of the difference between a carrier's forward-looking economic cost of providing supported services and a national benchmark figure for non-rural LECs.[4] In response to the *Universal Service Order*, Vitelco joined a diverse group of commenters urging the Commission to reconsider its decision. Vitelco and the other parties demonstrated that the current approach to determining universal service support violated Section 101 of the Telecommunications Act of 1996 ("1996 Act")[5] because it would not provide sufficient universal service funding. Vitelco also demonstrated that the 25/75 split between federal and state support of the high cost fund would have a devastating impact on phone service in the U.S. Virgin Islands.

In July of 1998, the Commission referred several issues to the Joint Board for its recommendations in response to these petitions and to the concerns raised by the state members of the Joint Board. These issues referred to the Joint Board included the 25/75 split, as well as, other issues, including how the federal policy should address changes in interstate access

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3 47 U.S.C. § 254.

4 *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776 (1997) (*"Universal Service Order")*.

5 47 U.S.C. § 254.

charges; how federal policy should support explicit support mechanisms at the state level; and how federal revenues should be collected (i.e. what revenue base to use). The Joint Board's *Second Recommended Decision* was its response to the Commission's questions.[6]

## II. THE COMMISSION SHOULD FOLLOW A "HOLD HARMLESS" POLICY

The Joint Board, in devising a high cost funding method, was guided by the principle "to continue to hold states harmless, so that no non-rural carrier ... will receive less federal high cost assistance than the amount it currently receives from explicit support mechanisms."[7] The Commission should adopt this policy to the extent it has not formally done so already.

The "hold harmless" philosophy elucidated by the Joint Board addresses two concerns. The first concern, as raised by the Joint Board, is that "significant decreases in the support that goes to a particular carrier could have a notable impact on consumers' rates."[8] The explanation is simple. The funds a carrier receives from universal service represent a stream of income. If that income were to suddenly decrease dramatically, the carrier would need to make up that lost income to continue its operations. One readily available source of additional income to cover this shortfall is through increased rates. The second concern was raised by the Commission in its

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[6] Vitelco recognizes that the FCC may decide that this proceeding only addresses non-rural carriers. Nevertheless, Vitelco, an insular and rural carrier, is concerned that the FCC might choose to adopt the same rules for both rural and non-rural carriers. Therefore, Vitelco is participating in this phase of the universal service proceedings in order to protect its interests.

[7] *Second Recommended Decision* at ¶ 53.

[8] *Id.* at ¶ 51.

report to Congress when the agency found that "no state should receive less federal high cost assistance than it currently receives."[9] The Commission should maintain this policy.

A clear example of why it is vital that the universal service fund hold states and carriers harmless is the situation faced by today's telephone customers in the U.S. Virgin Islands. The Universal Service Fund contributes more than $20 per line in monthly support to Vitelco's subscribers. If federal funding levels to the U.S. Virgin Islands were cut, the reductions would have serious consequences on the affordability of telephone service for the Islands' subscribers. For example, if support levels were reduced by only twenty-five percent, Vitelco would be required to offset this cut by increasing rates by five dollars per line, per month. As a result, in this scenario, basic rates which are already relatively high[10] would increase even further, going up another twenty-seven percent.[11] In short, if the Islands' federal funding were reduced, Vitelco would be forced to increase rates significantly in contravention of congressional intent.[12]

## III. THE TWO-STEPS OF THE FUNDING METHODOLOGY RECOMMENDED BY THE JOINT BOARD FAIL TO ACCOUNT FOR THE UNIQUE CHARACTERISTICS OF SOME CARRIERS' SERVICE AREAS

In order to hold carriers harmless, the Joint Board recommended that the current 25/75 split be replaced with a two-step methodology that would examine both an area's need for

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9 *Federal State Joint Board on Universal Service*, 13 FCC Rcd 11501, 11602 (1998).

10 The national average for local, unlimited calls is $13.70 for residential and $32.54 for business. In the U.S. Virgin Islands, however, those rates are $18.55 and $49.85, respectively. *See* Trends in Telephone Services Industry Division (Feb. 1998).

11 Rates would now climb to $23.55/month, $9.85 (or 72%) above the national average.

12 Rates would increase because the Islands lack the ability, through alternative means, to generate enough intrastate support to cover a reduction in federal funding. *See* Section III, *infra*.

support and the ability of the local jurisdiction to provide support. Vitelco applauds these efforts. However, the devil lurks in the details of the implementation of each step because they fail to capture accurately the unique situations and needs under which carriers operate.

### A. Step One: A Forward-Looking Cost Model Fails To Account for the Unique Characteristics of Rural and Insular High Cost Areas

One such devil is found in the use of a forward-looking cost model to determine the level of federal support available to carriers "with costs significantly above the national average and whose average costs ... significantly exceed the national average."[13] Such cost models fail to reflect the costs of providing service if the service area faces significant unique costs.

In the case of the territory served by Vitelco, the U.S. Virgin Islands are an unusually high-cost area as various geographic factors raise the costs of providing service there. For example, frequent tropical storms and hurricanes (including recent devastation in the past two years by Hurricanes Marilyn, Bertha, and Georges) can unexpectedly destroy large parts of the telecommunications infrastructure requiring expensive repair and replacement. Also, the fact that Vitelco's service area is divided by water raises the costs of bringing services to customers. Additionally, costs on the Islands spiral upward because equipment must be routinely replaced due to the extreme weather conditions including heat, corrosive salt air and wind damage.

Further, the geology and topography make it expensive to provide service in this area. Because part of the islands were formed from a volcano, the Islands' are largely volcanic rock and their topography is irregular and mountain-like. This makes every aspect of the provision of telephone service including construction, ongoing maintenance, and access to outside plant

[13] *Second Recommended Decision* at ¶ 19.

extremely difficult. For instance, steep terrain and volcanic rock require additional guying and anchoring. Finally, the U.S. Virgin Islands are a completely isolated territory. The Virgin Islands are located in the middle of the Caribbean Sea some 1200 miles off the coast of Florida. Because the U.S. Virgin Islands are not accessible through the efficient transportation networks that exist on the mainland, any manpower, equipment, and materials necessary for the provision of service must be shipped into the territory at a much higher cost. Unfortunately, these costs are recurrent because the Islands do not have a production-based economy. In fact, Congress recognized the unique cost conditions of insular areas when it enacted the 1996 Act.[14]

Given all of these unique factors, the end result of any forward-looking cost model could result in unwarranted reductions in universal service support that would be harmful to the provision of universal service in the U.S. Virgin Islands. Thus, in the case of states and territories like the U.S. Virgin Islands, Vitelco strongly recommends that the Commission continue to use the existing embedded cost mechanism.

### B. Step Two: The Joint-Board's Recommendation Fails To Include Relevant Factors in Determining Intrastate Funding Ability

Other devils are hiding in the details of the second step. Under this step, a carrier would qualify for additional federal support in cases where "a state would find it particularly difficult to achieve reasonably comparable rates absent such federal support."[15] It is vital that any high cost funding method include an examination of a state's ability to internally offset any reductions in

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[14] Congress intended for the Commission to consider consumers in insular areas, such as the Virgin Islands, when developing support mechanisms for consumer access to telecommunications and information services. H. Rept. No. 104-458, at 131 (1996).

[15] *Second Recommended Decision* at ¶ 19.

funding that might be required after general needs have been determined. However, the Board's suggestions for determining a state's ability to provide internal support fail to include other very important factors that also go to the ability of a state to cover any federal shortfalls.

One factor the Joint Board ignores is the economic conditions under which a carrier provides service. For example, in the Virgin Islands, the factors making it a high cost area are exacerbated by economic conditions. The Islands' cost of living is 30 percent higher than the national average, and its tourism-based economy is declining. Further, nearly a quarter of the Islands' population live below the poverty line.[16] Telephone service is difficult to maintain even for those above the poverty line because the average disposable income here is only sixty percent of that of the United States. Each of these conditions makes it extremely difficult for the territorial Commission to devise a means of collecting additional costs from internal sources. Any rate increase caused by a reduction in universal service support would render telephone service unaffordable for many residents and have an adverse affect on subscribership levels, which are already significantly below that of the United States.[17]

Another factor the Board fails to include is an examination of the telecommunications structure of the state or territory. For instance, one particular problem in the U.S. Virgin Islands

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16 The 1990 U.S. Census reported that 23.2 percent of the people in the U.S. Virgin Islands live below the poverty line. 1990 Census of Population, Social and Economic Characteristics, Virgin Islands of the United States (1990 CP-2-55). In the mainland U.S., less than 14 percent of the population lives below the poverty line.

17 The United States enjoys telephone penetration rates of nearly 94 percent while the Virgin Islands has a penetration rate of approximately 87 percent. The Commission has noted that "subscribership levels provide relevant information regarding whether consumers have the means to subscribe to universal service and, thus, represent an important tool in evaluating the affordability of rates." *Universal Service Order*, 12 FCC Rcd at 8838.

is that *no intrastate toll service exists in the territory to allow the territorial Commission to generate additional funding to subsidize high-cost local service.* Without this alternative source of funding, the only source of funds available to the territorial Commission to offset a reduction in the federal contribution is to raise the rates of the telephone subscribers of the Territory. However, the territorial Commission's ability to increase rates is further limited (in addition to the Islands' economic conditions) by the small customer base of fewer than 60,000 local loops. This means that any required cost increase cannot be widely dispersed. Any increase would hit every ratepayer hard.

Finally, the Joint Board's analysis of a state's ability to fund fails to account for the fact that, given the telecommunications structure in the U.S. Virgin Islands, any additional funding of universal service would come from the very same people who receive it. The small customer base and the lack of intrastate toll means that each dollar of reduced federal funding would result in a dollar of rate increases. Even if only business rates are raised, given the insular nature of the territory and the non-export nature of the economic base, customers on the Islands would pay for any increase. The overall effect of this "transfer" is that the funds used to support universal service would be coming from the very people who were supposed to be receiving those funds. In essence, the citizens of the U.S. Virgin Islands would be robbing Peter to pay Paul. This effect should also be considered when the Commission looks to see if a state can afford to offset any reductions in federal high cost support.

## IV. ANY UNIVERSAL SERVICE METHODOLOGY MUST ENSURE THAT RATES ARE COMPARABLE ACROSS EVERY STATE AND TERRITORY

The central purpose of universal service "is to ensure that consumers in high cost areas have access to telecommunications and information services that are affordable and reasonably comparable to those in urban areas, at rates reasonably comparable to those urban areas."[18] However, in order for the greater goal of universal service to be achieved (i.e., access on a national scale), it is imperative that the notion of 'comparability' not be construed too narrowly, otherwise telecommunications services in particularly costly areas of the country could become inaccessible. In response to this concern, the Joint Board correctly interprets 'comparability' as "a fair range of urban and rural rates both within a state's borders, and among states nationwide."[19] This approach will create a national standard by which all rates can be measured. By adopting this interpretation, the Commission will guarantee that rates for all Americans, living in all areas of the country, will be affordable for all.

## V. THE STUDY AREA IS THE PROPER LEVEL AT WHICH TO EXAMINE LOCAL COSTS

Vitelco also supports the Joint Board's recommended change to the size of the area over which costs are averaged. Currently, the Commission requires that costs for providing service be determined at the wire center level or lower.[20] The Joint Board recommends that the area be expanded to measure costs at the study area level which is the "area served by a local exchange carrier in a single state."[21] Again, as in the case of determining rates discussed above, measuring costs in too small an area would create unreasonable distortions in the measurement of the costs of providing service. Vitelco agrees with the Joint Board's rationale for this change in that

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[18] *Second Recommended Decision* at ¶ 14.

[19] *Id.* at ¶ 15.

[20] *Universal Service Order*, 12 FCC Rcd at 8884 (¶ 193).

[21] *Second Recommended Decision* at ¶ 32.

determining costs at this level of aggregation "will properly measure the support responsibility that ought to be borne by federal mechanisms given the current extent of local competition."[22]

## VI. THE FEDERAL COMPONENT OF UNIVERSAL SERVICE IS SEPARATE AND INDEPENDENT OF THE STATE COMPONENT

Vitelco agrees with the Joint Board's recommendation that universal service activities at the state level are independent from the activity at the federal level. The Congress has charged the federal fund to provide "those amounts necessary to establish a standard of reasonable comparability of rates across states."[23] States are free to supplement or not to supplement this federal contribution.[24] In some instances, such as those described above, a state cannot assist the federal government in maintaining 'reasonable comparability' and will require, as the FCC is obligated to provide, additional federal funding so that the statutory mandate is satisfied.

## VII. CONCLUSION

The Joint-Board has correctly concluded that the 25/75 split fails to satisfy the statutory requirements of the universal service provisions of the 1996 Act. Its recommended methodology represents a step in the right direction, however, additional details must be worked out. Vitelco urges the Commission to consider the particular needs and requirements of insular carriers when

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22 *Id.* at ¶ 33.

23 *Id.* at ¶ 37.

24 Thus, the Joint Board is correct in its conclusion that "no state can or should be required by the Commission to establish an intrastate universal service fund." *Id.* at ¶ 38.

it acts to adopt a final methodology to provide federal funding. Only then will the central purpose of universal service, affordable rates for all Americans, be achieved.

Respectfully submitted,

VIRGIN ISLANDS TELEPHONE CORPORATION

By: Samuel E. Ebbesen / DJ

Samuel E. Ebbesen
President & Chief Executive Officer
Virgin Islands Telephone Corporation
P.O. Box 6100
St. Thomas, USVI 00801-6100
(340) 775-8617

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